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**Before the**
**Federal Communications Commission**
**Washington, D.C. 20554**

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| In the Matter of | ) | |
| | ) | |
| Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 -- Rate Regulation; | ) | MM Docket No. 93-215 |
| | ) | |
| Adoption of a Uniform Accounting System for Provision of Regulated Cable Service | ) | CS Docket No. 94-28 |

**REPLY COMMENTS OF CONTINENTAL CABLEVISION, INC., CROWN MEDIA, INC., JONES INTERCABLE, INC., KBLCOM, INC., SCRIPPS HOWARD CABLE CO., TELECABLE CORPORATION, GREATER MEDIA, INC., RIFKIN & ASSOCIATES, INC., TCA CABLE, INC., WESTERN COMMUNICATIONS, ALLEN'S TV CABLE SERVICE, INC., AMERICAN CABLE ENTERTAINMENT, BENCHMARK COMMUNICATIONS, BROWNWOOD TELEVISION CABLE SERVICES, INC., CABLEAMERICA CORP., CABLESOUTH, COLUMBUS TELEVISION CABLE CORP., DANIELS CABLEVISION, INC., GILMER CABLE TELEVISION CO., HALCYON COMMUNICATIONS, INC., JAMES CABLE PARTNERS, OCB CABLEVISION, INC., SJOBERG'S INC., STARSTREAM COMMUNICATIONS, UNITED VIDEO CABLEVISION, ZYLSTRA COMMUNICATIONS CORP., CABLE TELEVISION ASSOCIATION OF GEORGIA, CABLE TELEVISION ASSOCIATION OF MARYLAND, DELAWARE AND THE DISTRICT OF COLUMBIA, NEW JERSEY CABLE TELEVISION ASSOCIATION, SOUTH CAROLINA CABLE TELEVISION ASSOCIATION, TENNESSEE CABLE TELEVISION ASSOCIATION, AND TEXAS CABLE TV ASSOCIATION REGARDING THE INTERIM COST-OF-SERVICE RULES AND THE FURTHER NOTICE OF PROPOSED RULEMAKING**


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## EXECUTIVE SUMMARY

In the initial round of comments in this matter, the undersigned cable operators and associations[1] identified certain areas where the Commission's interim cost-of-service rules should be improved before being made permanent. These reply comments address three major issues raised in the initial comment round.

First, the Commission should reject the ad hoc approach to "regulatory parity" relied upon by telephone company commenters. There are some similarities between cable and telephone companies, but the differences between them — including their histories, the technologies they use, their staffing arrangements, and the statutory regimes to which they are presently subject — are profound. As a result, appeals to "parity" by interested parties in regulatory proceedings should be viewed with suspicion, and the Commission should reject, specifically, the claim that the cable television price cap plan should include a productivity offset patterned on the offset included in the telephone company price cap plan; the claim that the same affiliate transaction rules that apply to telephone companies should also apply to cable companies, and the claim that the Commission should adopt a

[1] The participating cable operators include: Continental Cablevision, Inc., Crown Media, Inc., Jones Intercable, Inc., KBLCOM, Inc., Scripps Howard Cable Co., TeleCable Corporation, Greater Media, Inc., Rifkin & Associates, Inc., TCA Cable, Inc., Western Communications, Allen's TV Cable Service, Inc., American Cable Entertainment, Benchmark Communications, Brownwood Television Cable Services, Inc., CableAmerica Corp., CableSouth, Columbus Television Cable Corp., Daniels Cablevision, Inc., Gilmer Cable Television Co., Halcyon Communications, Inc., James Cable Partners, OCB Cablevision, Inc., Sjoberg's Inc., Starstream Communications, United Video Cablevision, Zylstra Communications Corp. The participating state associations include: Cable Television Association of Georgia, Cable Television Association of Maryland, Delaware and the District of Columbia, New Jersey Cable Television Association, South Carolina Cable Television Association, Tennessee Cable Television Association, Texas Cable TV Association.

Uniform System of Accounts for cable. If the Commission perceives a need to harmonize its regulation of cable and telephone, it should initiate a notice of inquiry to seek balanced and informed input on what "parity" is possible and appropriate in light of the current and expected future circumstances of the two industries.

Second, the Commission should clarify its objectives regarding the experimental "Upgrade Incentive Plan." The Commission should maintain a flexible approach in this area and consider any proposals cable operators may present. Nonetheless, the entire process would be enhanced if the Commission were to state more clearly its key objectives for any arrangements to be approved under the Plan. In addition, the Commission should clarify its plenary responsibility to set public policy objectives and establish the framework for all cable regulations, including local franchising authority regulations, and particularly in connection with arrangements under the Upgrade Incentive Plan. While input from affected local franchising authorities will always be helpful, the Commission should make clear that a franchising authority with an unreasonably narrow view of the benefits of a publicly beneficial system upgrade may not prevent the upgrade from occurring by means of the threat of a harsh regulatory response.

Finally, the Commission should revise its procedural rules for reviewing cost-of-service cases. Events that have occurred since the initial comments demonstrate the need for improved procedures regarding the provision of cost-of-service information to regulators, the format in which that information is to be supplied, and procedures for receiving and responding to questions from the Commission's staff.

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These reply comments address three issues: the argument advanced by some telephone companies that the Commission should determine how to regulate cable operators on the basis of supposed "parity" with telephone regulation; the Commission's proposed "Upgrade Incentive Plan"; and the procedures the Commission and local franchising authorities should use in reviewing cable cost-of-service showings.

These reply comments supplement the comments filed by the undersigned cable operators and associations on July 1, 1994.[1] As stated there, we believe that the Commission, in its interim cost-of-service rules,[2] has made substantial progress in the difficult task of fashioning workable cost-of-service rules to apply to the unique circumstances of the cable industry. We urge the Commission to adopt the improvements to its cost-of-service rules suggested there, as well as those described below, in developing its permanent cost-of-service rules.

## I. THE COMMISSION SHOULD NOT DECIDE HOW TO REGULATE THE CABLE INDUSTRY BASED ON AD HOC CLAIMS OF "REGULATORY PARITY."

Commenters from the telephone industry continue to claim that "regulatory parity" provides a basis for the Commission to decide complex issues of regulatory policy.[3] Some, like Bell Atlantic, rely on "regulatory parity" primarily as a basis for imposing unwarranted

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[1] Comments of Continental Cablevision, Inc., Crown Media, Inc., Jones Intercable, Inc., KBLCOM, Inc., Scripps Howard Cable Co., Telecable Corporation, Greater Media, Inc., Rifkin & Associates, Inc., TCA Cable, Inc., Western Communications, Allen's TV Cable Service, Inc., American Cable Entertainment, Benchmark Communications, Brownwood Television Cable Services, Inc., Cableamerica Corp., Cablesouth, Columbus Television Cable Corp., Daniels Cablevision, Inc., Gilmer Cable Television Co., Halcyon Communications, Inc., James Cable Partners, OCB Cablevision, Inc., Sjoberg's Inc., Starstream Communications, United Video Cablevision, Zylstra Communications Corp., Cable Television Association of Georgia, Cable Television Association of Maryland, Delaware and the District of Columbia, New Jersey Cable Television Association, South Carolina Cable Television Association, Tennessee Cable Television Association, and Texas Cable TV Association Regarding the Interim Cost-of-Service Rules and the Further Notice of Proposed Rulemaking, In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 — Rate Regulation; Adoption of a Uniform Accounting System for Provision of Regulated Cable Service, MM Docket No. 93-215; CS Docket No. 94-28 (filed July 1, 1994) (Comments of Cost-of-Service Parties).

[2] In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, ***Report and Order and Further Notice of Proposed Rulemaking***, MM Docket 93-215, FCC 94-39 (released March 30, 1994) (***"Cost of Service Order"***).

[3] ***See, e.g.,*** Bell Atlantic Comments, ***passim;*** GTE Comments at 3, 6-10; BellSouth Comments at 2, 8-9.

burdens on the cable industry.[4] Others, like BellSouth, also rely on "regulatory parity" as a foil for arguing that particular aspects of cable regulation should be applied to telephone companies as well.[5]

At the outset, the local exchange carriers' claim that cable and telephone companies should be regulated in essentially the same way seems overblown in light of the significant differences in the ways that different groups of telephone companies are regulated. Long distance carriers are subject to a different regulatory scheme than are local exchange carriers, both at federal and state levels; AT&T, the dominant long distance carrier, is subject to different regulatory obligations than are non-dominant long-distance carriers; and local exchange carriers are subject to somewhat different regulatory obligations than are competitive access providers. In addition, cellular carriers — whose services would appear to compete most directly with existing local exchange services — are regulated quite differently than are local exchange carriers. If the Commission has concluded that significant differences among the regulation of these ***telephone companies*** are appropriate, it would seem odd indeed to conclude that differences between the regulation of local exchange carriers and ***cable companies*** cannot be tolerated.

In fact, as described below, the cable and telephone industries are too different for any appeal to "parity" or "symmetry" to be accepted at face value. There is certainly no basis, moreover, for the claim that cable regulation is generally more favorable than that

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4 *See* Bell Atlantic Comments at 2, 4, 9-13.

5 *See* BellSouth Comments at 6-7.

to which local exchange carriers are subject.[6] Each regulatory regime contains significant burdens that the other does not contain. Not surprisingly, however, local exchange carrier appeals to regulatory parity seem never to take account of the unique burdens, described below, to which cable operators are subject, but local exchange carriers are not.

For these reasons, the Commission should reject the argument that "regulatory parity" requires the application of certain aspects of telephone regulation to cable companies, including, specifically, a productivity offset in the cable industry's price cap plan; a requirement for a uniform system of accounts; and telephone-based rules governing transactions with affiliates. To the extent that the Commission believes that cable and telephone regulation should be harmonized, it should initiate a notice of inquiry to seek balanced and informed input on what "parity" is possible and appropriate in light of the current and expected future circumstances of the two industries.

### A. There Are Fundamental And Profound Differences Between The Cable And Telephone Industries.

Telephone companies are enormously profitable businesses, with aggregate retained earnings measured in the billions of dollars. They have virtually total control of their core markets of residence and business local exchange services, and of access services provided to interexchange carriers.[7] Their facilities pass well over 90% of potential customers, and have done so for decades. Their penetration, on average, is more than 90% of the entire

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[6] *See* Bell Atlantic Comments at 3.

[7] Economics & Technology, Inc./Hatfield Associates, Inc., ***The Enduring Local Bottleneck*** ii-iii (1994).

potential market. They have paid consistent dividends for decades, and the debate among securities analysts — despite the beginnings of some competition in some local exchange markets — is about the level of dividend ***growth*** that can be expected for the future.[8]

Cable companies are generally not profitable. Moreover, where profits exist on a current basis, there are often large retained losses that must be recouped before the business will have made any money for its investors. Cable companies generally pay no dividends, and generally have no plans to do so. While cable facilities now pass more than 90% of homes, this was achieved only within the last few years. Furthermore, cable companies have, on average, achieved only about 60% penetration. Telephone companies have not had such a low average penetration since 1949.[9]

In addition, over the course of the last ten years, the number of national cable video networks has more than doubled.[10] In order to be able to accommodate this explosion in new programming, many cable operators have substantially upgraded the capacity of their systems to offer additional channels. Indeed, the massive capital expenditures required to build out and enhance the nation's basic cable infrastructure is a major contributor to the industry's overall position of retained losses.

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[8] ***See*** Comments of Cost-of-Service Parties at Exh. G at 52-3.

[9] ***See*** Schement, ***Telephone Penetration, 1876-1970*** at 3 (Feb 15, 1994) (FCC Office of Plans and Policy Consumption Project).

[10] NCTA, ***Cable Television Developments*** at 7-A(April 1994).

There are other profound differences between the two industries. Seven of the eight largest local exchange carriers, serving a vast majority of residence and business customers throughout the country, sprang a decade ago from a horizontally and vertically integrated monolith, AT&T.[11] AT&T for decades essentially controlled the nation's local telephone service, long distance telephone service, telephone equipment manufacturing and sales, and telecommunications research and development.[12] AT&T stopped growing through acquisition eighty years ago — with its dominance of the market already assured — by virtue of an informal agreement, called the "Kingsbury Commitment," between AT&T and the Attorney General of the United States.[13]

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[11] ***See generally United States v. American Tel. and Tel. Co.,*** 552 F. Supp. 131 (D.D.C. 1982) (approving divestiture of operating companies from AT&T).

[12] ***See generally id. See also id.*** at 165 ("In its present form, A&T has a commanding position" in the telecommunications industry). ***See also*** Statement of Anne K. Bingaman, Assistant Attorney General, Antitrust Division, before the Subcommittee on Economic and Commercial Law, Committee on the Judiciary, U.S. House of Representatives, concerning the Antitrust Reform Act H.R. 3626 (Jan. 26, 1994) at 5-6 ("local telephone markets ... are still monopolized by local companies in the old Bell System, the RBOCs... ." They "still have a lock on local telephone traffic, carrying more than 99% of all local calls in their service areas.")

[13] ***See*** R. McKenna, Preemption Under the Communications Act, 37 Fed. Com. L. J. 1, 8 (1985) ("The Bell System's aggressive program to acquire Independents was blocked by the Kingsbury Commitment, so that by the time AT&T was returned to private ownership in 1919 following brief wartime nationalization, the shape of the telephone industyr was set."); D. Burch, Common Carrier Communications by Wire and Radio: A Retrospective, 37 Fed. Com. L. J. 85, 86-7 (1985) ("AT&T, under the leadership of Theodore N. Vail, embarked upon an aggressive program of intimidation and acquisition in order to create a nationwide monopoly. ... These practices sparked a lengthy investigation by the Attorney General. However, by the time of the so-called Kingsbury Commitment in 1913, when AT&T agreed to cease its exclusionary practices, AT&T's monopolization of the telephone industry was well on its way to becoming an accomplished fact.") (footnote omitted).

No single cable company has ever served more than 18% of the nation's cable subscribers.[14] Indeed, the eight largest MSOs serve, in the aggregate, less than 50% of all cable subscribers.[15] Moreover, to the extent that the cable industry has been experiencing consolidation, that has occurred in large measure during the last decade. Cable companies are generally not affiliated with equipment manufacturers, and have never controlled the pace of the development of cable technology as did the integrated Bell System.

Cable and telephone networks are also very different. Telephone networks are designed around the need to switch enormous numbers of calls simultaneously from one point on the network to another. The calls being switched, however, are generally voice and low-bandwidth data, so a distribution plant comprised primarily of twisted pair copper has sufficed. The focus of telephone technology, therefore, has been on switching, multiplexing, and routing millions of calls. Moreover, because the traffic on a telephone network is driven by customer demand, the load on the network varies tremendously over the course of a day. A downtown switch handling tens of thousands of calls a minute during the business day, for example, may sit essentially idle from seven in the evening until eight in the morning.

Cable networks, by contrast, are designed around the need to deliver signals consuming enormous bandwidth (by telephony standards) to every customer on the network,

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[14] ***See*** NCTA, ***Cable Television Developments,*** pages 1-A (Basic Cable Households) 14-A (Top 50 MSOs).

[15] ***Id.***

twenty-four hours per day, seven days per week. The activities of a cable system head-end — the closest analogy, in terms of network architecture, to a telephone company's end office switch — do not vary with hour-to-hour changes in customer demand. The key technical challenge for cable systems, therefore, has not been switching, but signal distribution. Advances in cable networks have focused on determining the most cost-effective way to maintain the quality of high-bandwidth signals as they travel farther and farther from the head-end.

Finally, the statutory frameworks within which cable and telephone companies operate are also quite different. Telephone companies generally have, in effect, perpetual franchises. These are often "certificates of convenience and necessity" issued by state governments, which operate, as a matter of law, as a barrier to entry into the telephone company's business.[16] As public utilities, telephone companies often have the power to condemn private property to obtain necessary easements and rights-of-way.[17] On the federal level, telephone companies are common carriers, subject to Title II of the Communications Act, which, among other things, requires the filing of tariffs for regulated services and directs the Commission to prescribe a chart of accounts and depreciation rates.[18]

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[16] To use one example, not atypical of utility statutes throughout the nation, the Code of Virginia provides that no firm may offer telephone services without a certificate, and competing certificates will not generally be awarded absent some showing that existing services are inadequate. ***See*** Va. Code § 56-265.

[17] ***See, e.g.,*** Va. Code § 56-49.

[18] ***See*** 47 U.S.C. § 220. ***See also Cost-of-Service Order*** at ¶ 133, n. 280.

Cable companies generally operate under franchises granted by localities. These franchises have fixed terms, which means that the entire business is potentially at risk each time the franchise expires. Moreover, franchises are being granted for shorter terms. Whereas in the past a franchise term of ten to fifteen years would have been typical, franchise terms as short as five years are becoming more common. Also, while there was a period when franchises were generally exclusive, the 1992 Cable Act expressly forbids exclusive franchises.[19]

In addition, local franchise agreements often contain costly requirements, including franchise fees, the provision of financial and technical support for locally originated programming, free service to municipal buildings, separate institutional loops connecting municipal buildings without charge, and other items. Telephone companies are not subject to these types of requirements. To the contrary, their franchises are typically perpetual in nature, and often contain a state-mandated protection against competitive entry. At the federal level, the Cable Act neither requires nor permits "common carrier" type regulation of cable operators.[20]

These differences in the statutes applicable to the cable and telephone industries are probably fatal to any general claim that the Commission should be pursuing a goal of

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[19] 47 U.S.C. § 541.

[20] ***Cost-of-Service Notice*** at ¶ 15; House Report 102-628 at 83 ("It is not the Committee's intention to replicate Title II regulation. The FCC should create a formula that is uncomplicated to implement, administer, and enforce and should avoid creating a cable equivalent of a common carrier 'cost allocation manual'").

"regulatory parity." The Supreme Court recently reaffirmed the Commission's obligation to regulate the telephone industry in light of the Communications Act as it is written, not in light of the policy goals the Commission believes should apply to the industry, however worthy those goals might be.[21] Absent statutory changes, therefore, the Commission's legal authority to implement a policy of "regulatory parity" between cable and telephone may actually be quite limited, even if it is assumed that such a policy makes sense on the merits. As discussed below, that basic assumption is highly questionable.

### B. There Is No Basis For Any Claim That Regulation Of Cable Companies Is Generally More Favorable Than Regulation Of Telephone Companies.

In light of the significant differences between the telephone and cable industries, an impartial observer would not conclude that they should be regulated in the same way. Indeed, given their different circumstances, "similar" regulation would almost certainly have profoundly different effects on the two industries, which hardly suggests that the result of such a regulatory policy would be fair.[22]

The telephone companies go even farther, and claim that it is possible to discern from the complex of regulations applicable to the two industries a situation in which cable

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[21] ***MCI Telecommunications Corp. v. AT&T***, ___ U.S. ___, 129 L.Ed. 2d 182 (June 17, 1994).

[22] It has long been remarked that "equal" treatment does not necessarily properly address the different circumstances of those subject to it. ***See, e.g., Griffen v. Illinois,*** 351 U.S. 12, 23 (1956) (Frankfurter, J., concurring) ("'The law, in its majestic equality, forbids the rich as well as the poor to sleep under bridges, to beg in the streets, and to steal bread.'") (quoting A. France, in Cournous, ***A Modern Plutarch*** 27 (1928)).

regulation is generally more favorable than is telephone regulation.[23] As discussed below, there is no basis for any such conclusion.

Telephone rates are regulated on two levels, federal and state. Cable rates, by contrast, are regulated by this Commission, and by a myriad of local franchising authorities. Where a typical large telephone company may face one or two dozen regulatory bodies, a typical large cable company may face hundreds of different regulators. Moreover, as noted above, cable companies operate under franchises with specific, limited terms, issued by the same entities that regulate its rates, while telephone company "franchises" are, in effect, perpetual by operation of state law. This situation is hardly "favorable" to cable.

Cable rate regulation and telephone rate regulation are also quite different. The basic premise of the Commission's system of benchmark regulation is that the best way to estimate a reasonable, competitive rate for cable services over the long term is to observe how cable operators subject to immediate and direct competition behave in the short term. The rate decreases observed in that situation are then imposed, across the board, on all regulated cable services.[24] Telephone companies, by contrast, have generally been regulated on the basis of their costs of providing service. Over many decades, this results in a situation in which rate base and operating expenses gradually increase, so that shareholder

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[23] ***See*** Bell Atlantic Comments at 3.

[24] As noted elsewhere, we do not agree that the Commission has properly calculated the level of rate reductions that are appropriate under a system of "benchmark" regulation. ***See*** Comments of Cost-of-Service Parties at 19 n.30.

return continues to increase as well.[25] These differing regulatory approaches do not seem to "favor" cable.

If the telephone companies actually believed that cable regulation is superior, they would presumably support a wholesale conversion of the way they are regulated into the way cable is regulated. They would then be subject to time-limited, non-exclusive franchising in, and rate regulation by, every community in which they operate. They would also be subject to massive, across-the-board rate reductions as the Commission identified the degree to which telephone companies typically lower their rates when confronted with direct and immediate competition.[26] The fact that telephone companies do not support such an approach simply confirms the intellectual bankruptcy of their "regulatory parity" claims.

### C. The Commission Should Not Impose Regulatory Requirements On Cable Companies In Order To Achieve "Parity" With Telephone Companies.

There are three specific areas where the telephone companies urge the Commission to impose requirements on cable based on the fact that similar requirements either have been imposed on, or are under consideration for, telephone companies. These are the

[25] In the Matter of Policy and Rules for Dominant Carriers, ***Report and Order and Second Further Notice of Proposed Rulemaking***, 4 FCC Rcd. 2873, 2881 (1989); In the Matter of Policy and Rules for Dominant Carriers, ***Second Report and Order***, 5 FCC Rcd. 6786, 6790 (1990).

[26] It has been estimated, for example, that local exchange carriers will be permitted to lower special access rates by up to 30% in high-density, competitive areas. ***See, e.g.,*** In the Matter of Expanded Interconnection With Local Telephone Company Facilities, Amendment of Part 36 of the Commission's Rules and Establishment Of A Joint Board, ***Second Report and Order and Third Notice of Proposed Rulemaking,*** 8 FCC Rcd 7374 (1993) ¶ 37 & n.92. Under the benchmark methodology applied to cable television firms, this would justify a 30% across-the-board rate decrease for ***all*** local exchange carrier services.

proposed affiliate transaction rules,[27] the proposal to include a productivity offset in the cable industry price cap plan,[28] and the proposal to adopt a Uniform System of Accounts for cable operators.[29] Appeals to "regulatory parity" add nothing to the Commission's consideration of these issues.

### 1. Affiliate Transactions.

With regard to affiliate transaction rules, numerous commenters have explained in compelling detail why the proposal in the ***Cost-of-Service Order*** should be rejected.[30] From the particular perspective of regulatory parity, we would only add that the telephone industry has a long history of dealings with affiliates for many key aspects of operating costs, including equipment used in the network, research and development services, and customer premises equipment. For cable companies, by contrast, transactions with affiliates have generally played a minor role in overall system costs, because neither equipment nor R&D services have been provided by affiliates. Only in recent years, with the increasing development of video programming specific to cable, have transactions between affiliates become a significant issue in this industry. There is no realistic parallel between

[27] ***See*** Bell Atlantic Comments at 10-11.

[28] ***See*** Bell Atlantic Comments at 3-6.

[29] ***See*** Bell Atlantic Comments at 12.

[30] ***See, e.g.,*** NCTA Comments at 60; Turner Broadcasting Comments, ***passim;*** Time Warner Entertainment Comments at 20; Jones Education Networks Comments, ***passim***; Liberty Media Corp. Comments, at 18; Rainbow Programming Holdings Comments, ***passim***; and Discovery Communications Comments, ***passim***. Indeed, this is one case in which at least one telephone company, BellSouth, has concluded that not even cable firms should have to deal with the burdens of the proposed rules. ***See*** BellSouth Comments at 3-7.

transactions involving intellectual property such as copyrighted programming and transactions involving the equipment used to build and operate a network.[31]

### 2. Productivity Offset.

With regard to the productivity offset in the price cap plans for the two industries, the very different ways in which the cable and telephone industries have been regulated indicate that a similar productivity offset for the two industries is unsupported by the record or history and, therefore, would be utterly unwarranted. The reason for including a productivity offset in the telephone industry's price cap plan is that the telephone industry faces declining costs in real terms. Over time, therefore, improvements in productivity will allow the telephone companies to resist inflationary pressures.[32] A productivity offset insures that the telephone company's prices will not diverge too greatly from its underlying costs over time, and at the same time provides a financial incentive to try to become especially productive.

As we have previously explained, such an approach makes perfect sense in the context of the price cap plan for local exchange carriers, which represents the beginnings of a departure from the pure cost-of-service regulation that has characterized telephone regulation for the better part of a century.[33] In the cable context, however, Congress did

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[31] ***See*** BellSouth Comments at 3-7.

[32] Policy and Rules Concerning Rates for Dominant Carriers, ***Second Report and Order***, 5 FCC Rcd. 6786 (1990).

[33] Comments of Cost-of-Service Parties at 55-6.

not intend the Commission to regulate cable companies like common carriers,[34] and the Commission has repeatedly made clear that cost-based rate regulation is to be the exception, not the rule, for cable companies.[35] In these circumstances, grafting a productivity offset onto cable price caps is contrary to the entire thrust of the Commission's scheme for regulating cable rates.

Moreover, perhaps because telephone companies have evolved out of a century of monopoly status, while cable companies have a more entrepreneurial heritage, the staffing levels of the two industries also vary radically. A recent article in ***Forbes*** magazine reported that Ameritech, with about 33 employees per 10,000 access lines, was the "leanest" of the regional bell companies.[36] In contrast, cable companies have consistently averaged slightly fewer than 19 employees per 10,000 subscribers.[37] In light of these hard facts, it is difficult to see how an appeal to "regulatory parity" can support a claim that these two industries should have the same productivity offsets in their price cap plans. To the contrary, it is clear that, while cable companies cannot be expected to improve their

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[34] ***Cost-of-Service Notice*** at ¶ 15; House Report 102-628 at 83.

[35] ***See, e.g., Cost-of-Service Order*** at ¶ 5 ("In the Report and Order, we establish rules implementing a cost-of-service alternative to our primary benchmark and price cap approach to setting regulated cable service rates."); and ¶ 25 ("Our primary approach to rate regulation of cable service, the benchmark/price cap approach, is not cost-based and does not impose the concomitant regulatory burdens such as tariff and cost support obligations.")

[36] ***See*** Samuels, "A Meeting at the Breakers," ***Forbes,*** (June 20, 1994), at 56. The ***Forbes*** article reports that Ameritech has "just over 300 lines" per employee. This translates to 33.33 employees per 10,000 access lines.

[37] NCTA, ***Cable Television Developments*** at 6-A (employment) and 2-A (subscribers)(1994).

productivity by substituting capital for labor, the opportunities for telephone companies in this regard remain quite significant.

### 3. Uniform System of Accounts.

Finally, with regard to the Uniform System of Accounts, we have previously explained that the burden and expense involved in converting cable company accounting systems to a uniform accounting system are simply not justified by the benefits that might be obtained from such a requirement. To the contrary, the Commission will obtain information regarding cable company costs on a uniform and consistent basis from the Forms 1220 it will receive in cost-of-service cases.[38] In the case of telephone companies, by contrast, uniform accounting requirements have existed for decades. While the Commission might want to consider relaxing those accounting requirements as conditions warrant, the fact that they exist for telephone companies does not provide a basis for imposing them on cable companies.

### D. If The Commission Is Interested In Harmonizing The Regulation Of Telephone And Cable Companies, It Should Initiate A Notice Of Inquiry To Consider How That Goal Should Be Accomplished.

While the differences between the cable and telephone industries are profound, it is true that, in a few cases, cable systems have been modified to provide some limited telephone services. Similarly, some telephone networks have been extensively re-engineered to provide some video services. Moreover, industry pundits also claim that at some point in the future telephone companies and cable companies will have evolved into

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[38] *See* Comments of Cost-of-Service Parties at 63-4.

similar creatures.[39] These observations, however, do not change the fundamental differences between the two industries, and say nothing at all about the correct regulatory policies to apply either to the telephone or cable industries as they exist today.

If the Commission believes that the possible convergence of the two industries warrants some effort to harmonize the way in which they are regulated over time, it should initiate a Notice of Inquiry to consider the issue fully and completely. Parties would be free to present a full explanation of their views of how the industries are similar, how they are different, and what degree of similarity in regulation these circumstances warrant. Consideration of "regulatory parity" issues from other regulated industries could also be considered, if the Commission concludes that such information would be helpful.[40]

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[39] ***See, e.g.,*** McChesney, "Bell Atlantic, TCI Blame FCC Regulations for Dead Deal," National Public Radio, All Things Considered, Transcript No. 1403-1 (February 24, 1994)("Cable and telephone are converging.. .. The technology is driving us that way and there's no stopping it") (remarks of P.Huber).

[40] In this regard, Bell Atlantic submitted a declaration from Professor Robert Harris, who apparently was involved in the effort to reform the regulation of railroads in relation to the regulation of interstate trucking. Without undertaking a detailed rebuttal of Professor Harris's claims, we would note the following. First, he correctly observes that statutory changes were needed to allow regulators to treat railroads and truck lines the same way. Harris Declaration, ¶ 21 and n.24. The Supreme Court's recent admonition to the Commission to follow the terms of the Communications Act, ***see supra,*** n. 21, and the significant statutory differences between cable and telephone regulation, strongly suggest that statutory changes would be required to justify a policy of "regulatory parity" here. Second, in his historical review, Professor Harris notes that the effect of unfair regulation on railroads was extremely low earnings, including some bankruptcies, while truck lines presumably flourished as a result of regulatory protection. ***Id.*** at ¶ 21, ¶ 24 n.29. In the realm of communications, it is the telephone companies that are flourishing, free from meaningful competition, while the cable industry has, overall, extremely low or negative earnings and massive retained losses. This hardly suggests that it is the ***telephone*** companies that are in need of more relaxed regulation. Third, he argues that the restrictions on railroads were based on mistaken concerns about their ability and incentive to use their market power to destroy their competitors. ***Id.*** at ¶¶ 22-23. Assuming that Professor Harris is completely correct about the railroads, that says nothing about the incentive and ability of telephone companies to harm their competitors, any more than the fact that Defendant ***A*** is innocent of larceny means that Defendant ***B*** is also innocent in a separate, unrelated case.

Such a proceeding would also provide a useful forum for addressing several distinct questions which the advocates of "regulatory parity" tend to blur together. First is how telephone companies should be regulated in their core markets, both in general and in those cases where competition may be emerging. Second is how cable companies should be regulated in ***their*** core markets, again, in general and in the face of competition. Third is whether any special rules should apply to either one of these industries when the new actual or potential competitor comes from the other. Fourth is whether, if special rules should apply, telephone companies facing a cable-based competitor should be subject to the ***same*** special rules that would apply to cable companies facing a telephony-based competitor.

A simplistic invocation of the mantra of "regulatory parity" adds nothing to the correct resolution of these questions. To the contrary, it tends to obscure the many ways, some subtle and some obvious, that differences in the circumstances of the two industries justify differences in the regulations that apply to them.

In sum, therefore, if the Commission is interested in pursuing a goal of "regulatory parity" as between cable and telephone, it should initiate a proceeding to consider how to do so. In the absence of such a proceeding, however, the Commission should not rely on inchoate notions of "parity" to resolve specific regulatory questions for either the cable or telephone industries. Instead, in any given case, the Commission should consider whether its experience in regulating telephone companies provides useful guidance in the process of regulating the cable industry, or vice versa. Where the analogy seems apt, the

Commission should apply similar regulatory methods. Where the analogy does not, then the two industries should be regulated differently.

## II. THE UPGRADE INCENTIVE PLAN.

### A. The Commission Should Remain Flexible And Open-Minded Regarding Possible Arrangements Under The Upgrade Incentive Plan.

The National Association of Telecommunications Officers and Advisers and the City of New York (collectively, NATOA) raise the specter of declines in service quality, regulatory "gaming," and unreasonable price increases in connection with the Commission's Upgrade Incentive Plan.[41] These comments indicate a need for the Commission to clarify the intended operation of its Plan.

At the outset, we commend the Commission for including the Upgrade Incentive Plan in its interim rules.[42] Properly implemented, the Plan can speed the deployment of high-capacity, technically sophisticated, high-quality video services throughout the country, while at the same time avoid needless regulatory burdens.

We urge the Commission to maintain an open and flexible approach to proposed arrangements under the Upgrade Incentive Plan. Cable operators face a variety of different circumstances bearing on the timing and scope of feasible network upgrades, including different types of embedded cable system technology; different levels of market demand

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[41] Comments of NATOA at 2-3.

[42] ***Cost-of-Service Order*** at ¶¶ 295-304, 324-29.

for different types of services; different physical characteristics of their franchise areas (*e.g.,* urban v. rural); and different financial circumstances, including existing resources and access to external capital. No two proposed arrangements, therefore, will be exactly alike, and the Commission should encourage proposals that respond to the individual situation facing each operator.

Even so, it would be helpful on a going-forward basis for the Commission to articulate whether it has in mind any particular priorities regarding upgrades (*e.g.,* accelerating the deployment of optical fiber). A clear statement of the Commission's goals could help give focus not only to an operator's planning activities, but also to discussions between the operator and the affected local franchising authorities regarding the proposal.

The Commission should also recognize that an "incentive regulation" proposal for a cable television provider may not fit the usual model for incentive regulation plans applicable to telephone companies. In those situations, the telephone company usually faces present or near-term rate reductions if normal regulatory rules continue to apply. An incentive regulation plan eliminates or minimizes those reductions in exchange for the telephone company's agreement to take actions that might not otherwise occur in a reasonable time frame, such as a major infrastructure upgrade. The telephone company benefits by avoiding rate decreases, and the public benefits by virtue of the new and improved services the firm is able to offer.